The Commonwealth of Massachusetts
Massachusetts Senate

ANALYSIS OF THE STATE'S FISCAL CRISIS

Senate Committee on Post Audit and Oversight

Senate Post Audit and Oversight Bureau

Commonwealth of Massachusetts

MASSACHUSETTS SENATE

The Honorable William M. Bulger
President of the Senate

ANALYSIS OF THE STATE'S FISCAL CRISIS

A Report of the

SENATE COMMITTEE ON POST AUDIT AND OVERSIGHT

Sen. Richard A. Kraus, Chairman

Sen. W. Paul White, Vice-Chairman
Sen. Linda J. Melconian
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November 1989

The Commonwealth of Massachusetts

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November 29, 1989

Edward B. O'Neill
Clerk of the Senate
State House, Room 208
Boston, MA 02133

Dear Mr. O'Neill:

Pursuant to M.G.L. Chapter 3, Section 63 as most recently amended by Chapter 557 of the Acts of 1986, the Senate Committee on Post Audit and Oversight respectfully submits to the full Senate the following report: <u>Analysis of the State's Fiscal Crisis</u>.

This report is based on analysis by the Senate Post Audit and Oversight Bureau. It examines the nature and causes of the state's current fiscal situation.

Respectfully filed by the Senate Committee on Post Audit and Oversight:

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EXECUTIVE SUMMARY

Massachusetts is in the midst of a fiscal crisis more severe than any in recent history. The state has committed itself to spend more money than it is bringing in. There is a gap between expenditures and revenues estimated to be between $820 million and $1 billion. This report by the Senate Committee on Post Audit and Oversight is divided into sections summarized below.

1. THE NATURE OF THE CRISIS

Fiscal year 1990 expenditures have already been cut substantially.

- Appropriations in the fiscal year 1990 budget were over $50 million less than appropriations in fiscal year 1989; furthermore, the Governor has withheld $309 million from fiscal year 1990 appropriations.

- Inflation alone would bring the level of cuts up to $700 million for fiscal year 1990.

- There has been a $225 million increase in spending on the "non-discretionary" costs of Medicaid, debt service, state employee group insurance, pension payments, and contract assistance for the Massachusetts Bay Transit Authority (MBTA). Even with this increase, these items were under funded by $300 million.

Local communities are at risk.

- Cities and towns are increasingly depleting their cash reserves to meet current financial obligations.

The state's bond ratings are at their lowest rate in history, and are at risk of further decline.

Public works, education, health care, environmental protection and other essential services have been under funded.

2. THE CAUSES OF THE CRISIS

The state's economy has slowed.

- Employment growth has been slowing since 1988. The state's unemployment rate in 1988 was 3.3 percent, and as of October 1989, the unemployment rate was 4.5 percent. Higher unemployment results in lower income tax revenues and in greater costs in benefits.

- Layoffs in both the private and public sectors create consumer caution and results in lower sales tax revenues.

Tax revenue growth has dropped.

- Unanticipated tax revenue shortfalls in the past few years have resulted from federal tax changes and changes in the national economy that are difficult to project.

- Tax revenue growth in fiscal year 1989 was 6.5 percent, down from double-digit growth in the mid-1980's. In 1990, estimates put tax revenue growth at less than 1 percent.

- The strong downward trend in fiscal year 1990 sales taxes are signs of continued weakness in the economy and of weakened consumer confidence and spending.

Federal revenues have declined.

- Since fiscal year 1982, federal grants coming into Massachusetts have declined over $1 billion dollars in real terms, while federally mandated spending has not.

Revenue forecasts have been off.

- During fiscal year 1990, all estimates of tax revenues have over-predicted revenues, including estimates by the Administration, the Revenue Advisory Board, the Senate Committee on Ways and Means, the House Committee on Ways and Means, and the Massachusetts Taxpayers Foundation.

- In January 1989, the Administration estimated revenue growth for fiscal year 1990 at 7.4 percent. By November 1989, revenue estimates for fiscal year 1990 (net of dedicated taxes) had dropped to 0.7 percent.

- Any gap between revenues predicted and revenues actually collected must be made up by the end of the fiscal year, usually through expenditure cuts.

3. TRENDS IN STATE EXPENDITURES

Large portions of the state budget are "non-discretionary," and therefore difficult to cut. The one "discretionary" portion of the budget includes funding for essential governmental services, and must bear the burden of expenditure cuts. With only six months of the fiscal year remaining, implementing cuts from the "discretionary" third of the budget would require cuts of approximately 30 percent in these accounts.

Local aid represents one-third of the state budget; the current fiscal situation for local government makes local aid difficult to cut any further.

- From fiscal year 1984 to fiscal year 1990, total local aid went from 30.5 percent of the state budget to 34.9 percent. Fiscal 1990 was the first year that state aid to local governments did not grow, but in fact declined by $192 million or over 6 percent.

Entitlements such as direct and medical assistance currently represent another twenty percent of the budget, and are growing.

- From fiscal year 1987 to fiscal year 1990, Medicaid -- the single largest item in the state's budget -- has gone from $1.4 billion to $2.0 billion, about 16 percent of the total state budget.

- Payments for recipients of Aid to Families with Dependent Children represent over $550 million of the state budget. Other entitlement programs include emergency assistance, Supplemental Security Income (SSI), general relief, and services for the homeless.

Debt service, pensions and MBTA contract assistance are also "non-discretionary" expenditures for the state that continue to grow.

- In fiscal year 1990, general obligation bonds payments are expected to be $718 million, while pension payments are scheduled to be $646 million; together these represent 11 percent of the budget. From fiscal year 1987 to fiscal year 1990, MBTA payments went from $219.3 million to $395.4 million.

The bulk of cuts in the state budget come from one-third of the state budget in the "agency operations" accounts.

- From fiscal year 1984 through fiscal year 1989, agency operations actually shrunk as a percentage of the total budget, from 34.7 percent to 32.5 percent.

4. CONCLUSIONS: RESOLVING THE CRISIS

Even with a solution to this year's fiscal crisis, unless the state reins in its non-discretionary expenditures, or if revenues decline much further, the state is likely to experience another shortfall in fiscal year 1991.

The state's fiscal crisis is an opportunity for political leadership to take seriously its responsibility to define the shape and role of government for the foreseeable future.

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INTRODUCTION

Massachusetts is in the midst of a fiscal crisis more severe than any in recent history. This report by the Senate Committee on Post Audit and Oversight provides an overview of this crisis in which the state has committed itself to spend more than it is bringing in. The report was developed as an effort to offer information for the upcoming legislative debate on the state's expenditures and revenues.

This report is divided into four sections: the first reviews the extent of the crisis; the second looks at trends in state revenue collection and projection as one way of understanding the reasons for the crisis; the third examines trends in state expenditures as another way of understanding the crisis; and the fourth presents some of the implications of the fiscal crisis for governmental leadership and for the state's fiscal future.

SECTION ONE: THE NATURE OF THE CRISIS
How Bad is It?

The state's fiscal crisis is both broad and deep: it has already hit hard at government's social role, it has affected the operations of government at both the state and local levels, it has affected the state's financial marketing, and it is preventing the state from taking action on pressing social problems.

A. THE DEPTH OF CURRENT CUTS IN STATE EXPENDITURES

Already in fiscal year 1990, the state has made deep cuts in state expenditures. Appropriations in the fiscal year 1990 budget were $50 million less than appropriations in fiscal year 1989. Taking inflation into account, this is equivalent to a cut of $700 million. Furthermore, the Governor has withheld $309 million from money appropriated for agency operations and local aid in fiscal year 1990.

There has also been a $525 million projected increase in spending on Medicaid, debt service, state employee group insurance, pension payments, and contract assistance for the Massachusetts Bay Transit Authority (MBTA), essentially non-discretionary expenditures. Only $225 million of this increase has currently been budgeted, leaving $300 million unfunded.

Moreover, even with the expenditure cuts proposed by the Legislature at this time, the size of the budget deficit necessitates more cuts or revenues by the end of the year. The state's cuts in expenditures have already struck at the heart of governmental activity and are without parallel among the other states in the Northeast. The state has reduced the accessibility of higher education, cut preventive health programs, postponed the cleanup of hazardous waste, and cut numerous other programs such as court operations, day care, nutrition, and home care for the elderly.

B. LOCAL COMMUNITIES AT RISK

The state's fiscal crisis has also put local governments at risk of serious fiscal problems. A fiscal crisis at the local level creates a major threat to public education and other locally funded government services.

During the 1980's, cities and towns did not feel the full impact of the Proposition 2½ tax limitations because of increases in both local aid and non-tax revenue, and because a development boom expanded the local tax base. Now, however, non-tax revenues are down and the real estate boom has ended, but the state can no longer provide enough local aid to soften the impact of the Proposition 2½ tax cap.

There are two major indicators that the fiscal crisis has already affected municipal

finances. First, cities and towns have diminished capacity to make up for lost revenues through their own taxing powers. Data from fiscal years 1989 and 1990 show that local "excess levy capacity" -- the amount a locality can raise property taxes without passing a Proposition 2½ override -- has dropped dramatically. Between fiscal years 1987 and 1989, the number of towns with excess levy capacity dropped from 243 to 145. Second, towns are depleting their cash reserves to meet current financial obligations. Thirteen towns in fiscal year 1987 had no free cash; in fiscal year 1989 there were 44.[1]

C. THE STATE'S LOWERED BOND RATING

The severity of the state's fiscal situation is underscored by the state's lowered bond ratings. Massachusetts' current ratings are at their lowest levels in history, lower than the ratings of all other states in the nation except Louisiana.[2] It is important to realize that lowered ratings increase the state's borrowing costs and thereby worsen the state's fiscal situation. The drop in the state's bond ratings is directly related to the fiscal crisis, and there is strong evidence that unless the state takes action quickly, the bond ratings will drop even further.

D. SERIOUS UNDER FUNDING OF AREAS OF PUBLIC CONCERN

An additional indicator of the state's fiscal crisis is the state's inability to provide funding for major projects in areas of traditional governmental responsibility. For example, in the area of public works, projections from the Special Commission on Infrastructure Finance indicate that the state will require over $29 billion in additional general obligation debt to carry out such needed projects as bridge and highway repair

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[1] See An Impending Crisis: Local Government Finance, report of the Massachusetts Senate Committee on Post Audit and Oversight (December 1989 [forthcoming]).

[2] See State Budget Watch: November 1989, Massachusetts Taxpayers Foundation (November 1989), p. 3.

and water pollution abatement.[3] In the area of public education, the Senate Committee on Post Audit and Oversight recently found that Massachusetts has lagged behind competitor states in funding for public primary and secondary school education even during the 1980's.[4] Moreover, in health care, in environmental protection, in corrections and elsewhere in state government, crucial services and activities have been severely crippled due to chronic under funding.

SECTION TWO: THE CAUSES OF THE CRISIS
Why Are We In This Situation?

The current fiscal crisis has multiple causes. It is widely believed that the state is in a recession, but this is only a partial explanation. The roots of the crisis go beyond the economic health of the state. Factors contributing to the crisis include not only revenue shortfalls, but also reductions in federal funding and the state's inability to anticipate and project accurately declines in these sources of revenue.

A. THE STATE'S ECONOMIC DOWNTURN

Massachusetts is in the midst of an economic downturn, and the general economic trends are not likely to reverse immediately. A tightening of the state's labor market and downturns in high technology and the construction industries have contributed to an overall economic decline in the state.

Although the Massachusetts economy remains strong in comparison to other states,

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[3] See A Survey of Massachusetts Infrastructure Needs For The 1990's, report to the Massachusetts Special Commission on Infrastructure Needs for the 1990's (November 1989), p. i.

[4] See Massachusetts' Financial Commitment to Public Education in the Eighties: A Multi-State Comparative Study, Massachusetts Senate Committee on Post Audit and Oversight (October 1989), p. i.

employment growth has been slowing since 1988. The state's unemployment rate in 1988 was 3.3 percent, 2.2 percent lower than the national unemployment rate. At that time, Massachusetts had the lowest unemployment rate among the industrial states. As of October 1989, the unemployment rate was 4.5 percent, 0.8 percent lower than the national rate.[5]

The state's economy has a direct impact on tax revenue growth. With layoffs in both the private and public sectors, consumer caution and higher unemployment will continue to affect state revenues primarily in income taxes, sales tax revenue and in the collection of excise fees. When unemployment grows, the state also has higher costs in transfer payments.

B. TAX REVENUE SHORTFALLS[6]

Much of the state's fiscal problem lies in unanticipated shortfalls in tax revenues. The state did not anticipate these shortfalls largely because they resulted from federal tax changes and changes in the national economy, both of which are typically difficult to project.

Changing revenue growth is demonstrated in receipts from the state's three major tax revenue areas: personal income, sales, and corporate taxes. (Please see Table 1 below.) The strong downward trend in sales taxes is a sign of continued weakness in the economy and of weakened consumer confidence and spending. (Please see Figure A: Tax Revenue Growth for data on and illustration of the state's revenue situation.)

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[5] See "Official Statement, The Commonwealth of Massachusetts General Obligation Notes (Dedicated Tax Debt)" (November 16, 1989), p. 1.

[6] All data in this section (except where otherwise noted) are from the "Official Statement, The Commonwealth of Massachusetts General Obligation Notes (Dedicated Tax Debt)" (November 16, 1989).

TABLE 1:
TAX REVENUES BY SOURCE
Fiscal Years 1987-1990
(in millions of current dollars)

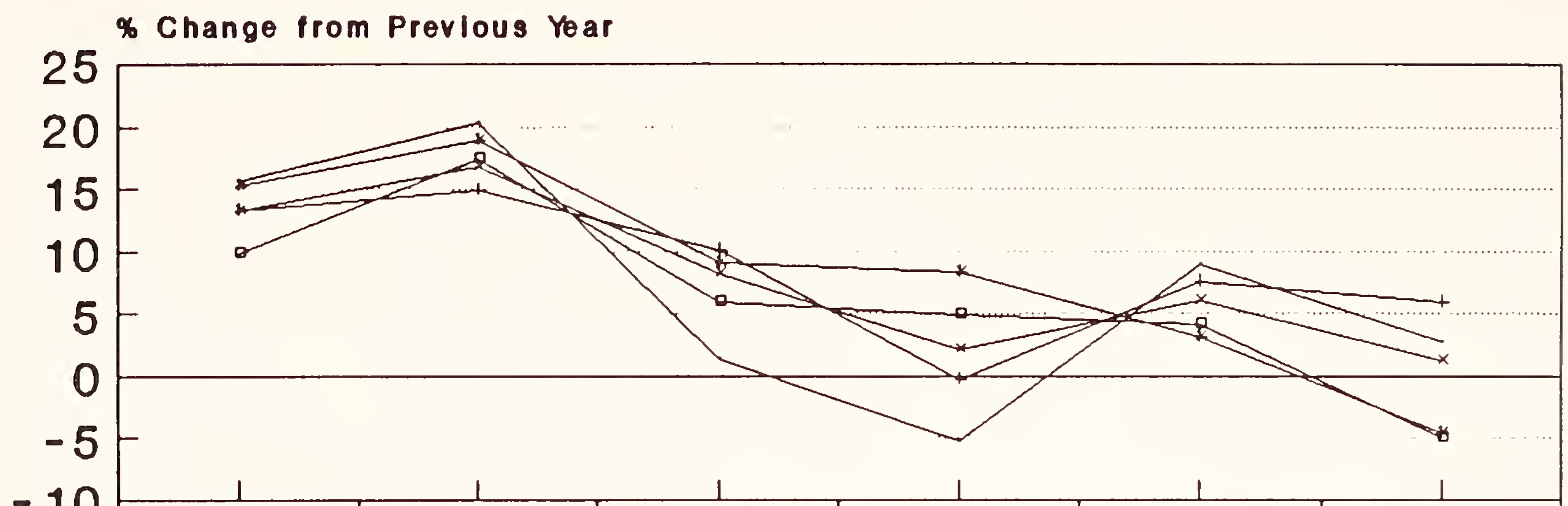
TAX SOURCE	FY87	FY88	%change	FY89	%change	FY90	%change
Corporate	814.1	771.8	-5.2	841.1**	9.0	865.0	2.8
Pers. Income	3995.6	3984.7	-0.3	4286.7	7.6	4540.1*	5.9
Sales	1865.8	2021.1	8.3	2084.0	3.1	1990.0	-4.5
Other	1426.9	1497.4	4.9	1558.6	4.1	1480.0	-5.0
TOTAL	**8102.4**	**8275.0**	**2.1**	**8770.4**	**6.0**	**8875.0**	**1.2**

*Does not include $445.8 million in dedicated revenues resulting from a temporary tax

**Does not include $46 million from legislative changes that required larger initial payments of capital gains

As of the date of publication of this report, the state is facing a budget deficit estimated to be between $820 million and $1 billion. Moreover, only one-half of the budget year remains to make up the gap.

Figure A: Tax Revenue Growth
Fiscal Years 1985-1990*



	1985	1986	1987	1988	1989	1990
Corporate	15.6	20.3	1.4	-5.2	9	2.8
Pers. Income	13.2	14.9	10.1	-0.3	7.6	5.9
Sales	15.3	18.9	9.1	8.3	3.1	-4.5
Other	9.9	17.4	5.9	4.9	4.1	-5
Total	13.3	16.8	8.2	2.1	6	1.2

MA General Obligation Notes, Nov. 1989
*1990 figures based on projections

During fiscal year 1987, elimination of the state's 2.5 percent surtax pushed down total revenue growth. In fiscal year 1987, however, income tax revenues were atypically high. The federal Tax Reform Act of 1986 triggered the realization of capital gains before December 31, 1986.

This was followed, however, by a steep drop in capital gains in 1987. Across the country -- from California and New York to Massachusetts -- states did not anticipate just how significant this decline would be for tax revenues in fiscal year 1988.[7] In addition, fiscal year 1988 tax returns also felt the losses due to the stock market decline of October 1987.

While the revenue shortfall in fiscal year 1988 was largely attributed to federal tax reform and loopholes in the Massachusetts corporate excise tax, the problems faced in fiscal year 1989 were substantially different. Sales taxes, which had shown healthy performance throughout fiscal year 1988, declined dramatically in fiscal year 1989. In fiscal year 1989, tax revenues grew only by 6.5 percent. In spite of state tax law changes that had been designed to offset anticipated lower tax revenues, the slow growth rate necessitated the state's using its entire $121.2 million Stabilization Fund to assist in bringing the budget into balance.

The continuing decline in state revenues is evidenced by the fiscal 1990 sales tax revenue declines. As unemployment and fear of unemployment increases, people are likely to postpone purchases of major consumer durables. Corporate revenues, tax revenues from commercial banks and savings institutions, and fees from deeds are also declining as the slowdown in the state's economy continues.

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[7] According to the Massachusetts Department of Revenue, after ten years in which capital gains growth had averaged 36 percent, Massachusetts had predicted a 25 percent decline in capital gains revenues in fiscal year 1987. When all income tax returns were filed and processed, capital gains revenues had actually dropped 55 percent -- below the level of even calendar year 1985.

C. DECLINES IN FEDERAL REVENUE

Since fiscal year 1982, federal grants coming into Massachusetts have declined an estimated $1 billion dollars in real terms. Since 1981, the federal government has dramatically and drastically reduced support for programs such as income support for poor families and elders, affordable housing, public service employment and waste water treatment plant construction.[8]

In spite of declining federal revenues, there has been no decline in federal mandates. This is particularly evident in the environmental field, where the federal government has mandated that Massachusetts address toxic waste disposal, sanitary waste water treatment and the Boston Harbor cleanup.[9]

Until fiscal year 1987, the declines in federal revenues were offset by gains in the state's own revenues. Because of recent declines in state revenue, however, the state can no longer fill in the gaps left by the federal government. The impact of decreased support from the federal government is therefore more pronounced than ever before.

D. REVENUE FORECASTS

Revenue forecasting is an imprecise science. Forecasts are most likely to be off when there are tax law changes or when there are unexpected economic events, both of which occurred during the past four years.

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[8] See House No. 1: Expanding Opportunity, Executive Budget Recommendations of His Excellency Michael S. Dukakis, Governor (January 27, 1988) Vol. I, Section I, p. 4.

[9] Senator W. Paul White, article for the Council of State Governments, December 1989 (forthcoming).

When forecasts over-predict revenues, the impact on the state budget is substantial. The state's expenditure levels are based on predicted revenues. Given the state's requirement for a balanced budget, any gap between revenues predicted and revenues actually collected must be made up by the end of the fiscal year, usually through expenditure cuts.

If, for example, the state does not recognize that revenues will fall short of expenditures until half-way through the year, the state will have to cut expenditures twice as much as they would have at the beginning of the year in order to close the gap before the year closes. The state would have to cut two dollars out of a half-year's operations to realize a savings rate of one dollar for the entire budget year.

The Administration has been criticized over the past year for the inaccuracy of its revenue predictions. People who think the Administration has been trying to make a case for a tax increase criticize the predictions as being too low, and people who think the Administration is trying to downplay a dire fiscal situation criticize the estimates for being too high.

In January 1989, projections of fiscal year 1989 revenue growth were 7.1 percent by the Executive Office of Administration and Finance and the Advisory Board on Revenue Resources and the State Economy ("Revenue Advisory Board"),[10] and 6.5 percent by the Massachusetts Taxpayers Foundation.[11] Actual revenue growth in fiscal year 1989 was 6.5 percent.

Also in January 1989, the Administration and the Revenue Advisory Board estimated

[10] See House No. 1: Expanding Opportunity, Vol. I, Section III, p. 14.

[11] See Growth in State Spending and Revenues: A Status Report, Massachusetts Taxpayers Foundation (January 30, 1989), p. 4.

revenue growth for fiscal year 1990 at 7.4 percent.[12] In June and July 1989, the House Committee on Ways and Means estimated revenue growth at 8.6 percent. At the same time, the Department of Revenue predicted a rate of 6.25 percent, and the Senate Committee on Ways and Means estimated at 6.1[13] percent. The Department of Revenue and the Senate Committee on Ways and Means were criticized by anti-tax forces for being overly pessimistic and for intentionally estimating low so as to justify new taxes.

By November 1989, revenue estimates for fiscal year 1990 have declined dramatically. The estimate from the Administration (net of dedicated taxes) as of November 16 had dropped to 0.7 percent. This estimate is over six percentage points lower than the initial estimate, a downward adjustment of more than 90 percent representing $800 million. The Massachusetts Taxpayers Foundation still estimates revenue growth of 3.7 percent; however, they are also likely to adjust their estimate downward.[14]

It is important to understand the differing impacts of over-predicting and under-predicting revenues. If revenues are under-predicted, the state will have set expenditure levels below the level of revenues actually collected. In this situation, towards the end of the year when the actual revenues become apparent, the state will have a surplus or will be able to support additional governmental services or cut tax rates.

On the other hand, if the state over-predicts revenues, the expenditure rate will be too high and the state will have to find ways to bring in new revenues or cut back on

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[12] See House No. 1: The Governor's Budget Recommendations for Fiscal Year 1990, His Excellency Michael S. Dukakis, Governor (January 25, 1989), Vol. 1, Section I, p. 55.

[13] See The New Fiscal Reality, The Senate Committee on Ways and Means Fiscal Year 1990 Budget Recommendations (June 1989), Vol. 2, p. 1-1.

[14] See State Budget Watch, p. 29.

expenditures mid-way through the year. Because of the risks involved in over-prediction, it important to be cautious in estimating revenues in times of economic uncertainty. In fiscal year 1990, the state has been reeling from the impacts of the unanticipated revenue shortfalls which became evident part-way through the year.

SECTION THREE: TRENDS IN STATE EXPENDITURES
Where Has the Money Gone?

As revenues coming into the state decline, and given the state's requirement for a balanced budget, the state has been forced to reduce expenditures. Cuts in state spending, however, are difficult to make for several reasons. First, much of the state's increased spending over the past several years went to local aid, which now accounts for over one-third of the total state budget. Because of the fiscal problems facing cities and towns, this part of the state budget is very difficult to cut.

Second, close to another third of the state budget is in so-called "non-discretionary" accounts. Expenditures in these non-discretionary accounts are mandated by statute and are growing at a rapid rate. According to a recent study by Senator Patricia McGovern, Chairman of the Senate Committee on Ways and Means, these accounts are the state's "budget busters," and include direct payment and entitlement programs, Medicaid for elders and families, the state's contractual obligations such as pensions for state retirees, and MBTA and general obligation bond payments.[15]

The only so-called "discretionary" portion of the state's budget is agency operations. Because local aid and "non-discretionary" accounts are difficult to cut, the state's "discretionary" accounts suffer the burden of expenditure reductions. (Please see Figure B: Expenditures by Category for illustration of the state's expenditure patterns.)

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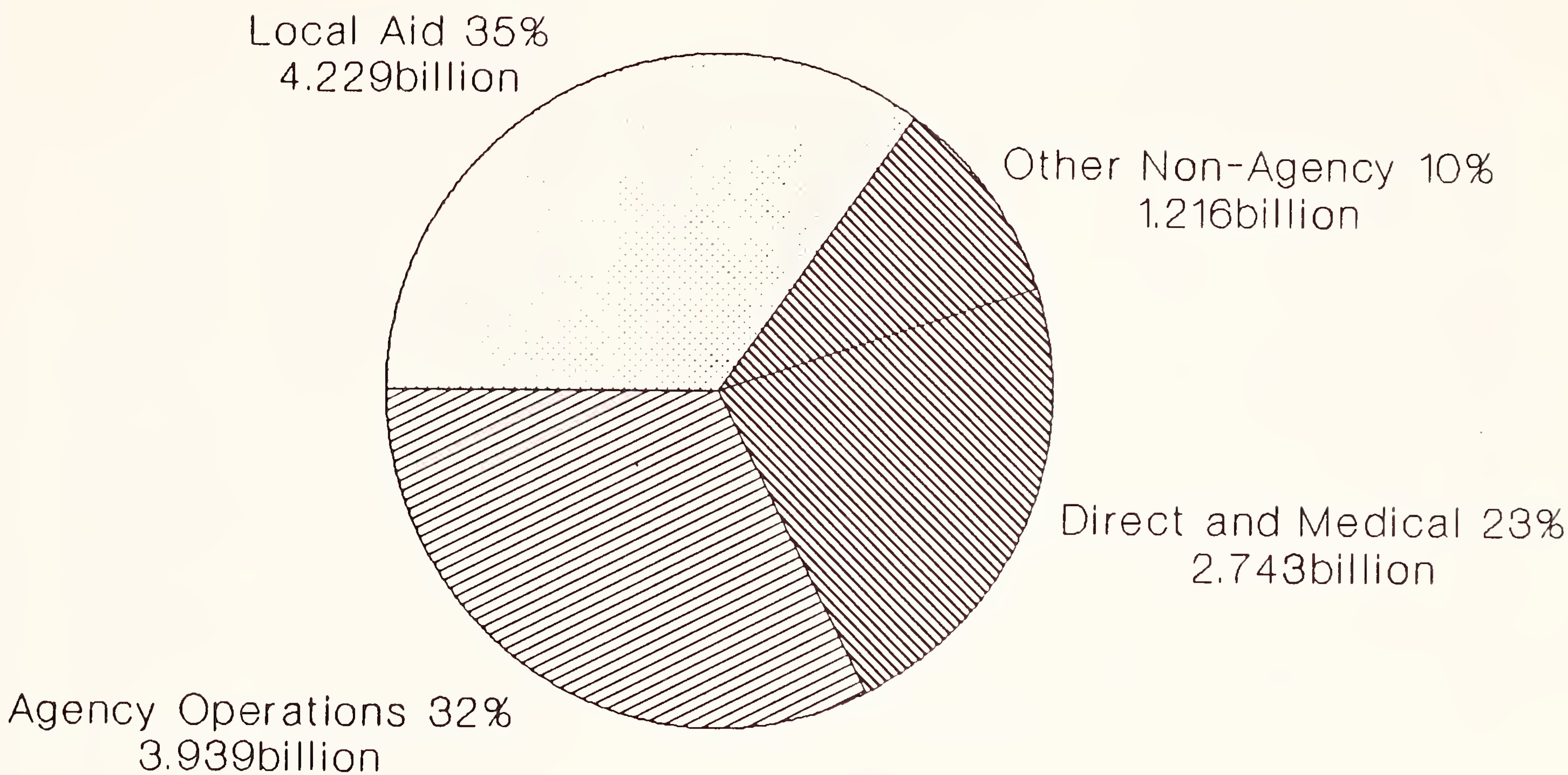
[15] See Bruce Mohl, "5 Accounts Threaten to Swamp Budget," Boston Globe (November 8, 1989), p. 1, cols. 1-4.

Figure B: Expenditures by Category
Fiscal Year 1990 (projected)



FY 1990 Budget Appropriation:
$ 12.127 billion

MA General Obligation Notes, Nov. 1989

A. LOCAL AID

When the state's economy was expanding, much of the growth in state government spending went to local aid -- one of the few areas that represented an increasing proportion of the state budget during the 1980's. From fiscal year 1984 to fiscal year 1990, total local aid went from 30.5 percent of the state budget to 34.9 percent. The state increased local aid, largely to offset the tax-limiting impact of Proposition 2½. Fiscal 1990 was the first year since 1969 that state aid to local governments did not grow. In fact, fiscal year 1990 local aid declined by $229 million or 8.5 percent.[16]

Cities and towns will continue to look to state aid to supplement municipal finances beyond the capacity of the municipality to raise taxes under the constraints of Proposition 2½. With the state's current fiscal crisis and the state's inability to supplement local aid, local governments are facing their own fiscal crisis.

B. DIRECT AND MEDICAL ASSISTANCE

Much of the state's spending goes to non-discretionary entitlements or direct payments to individuals. The single largest item in the state's budget is the Medicaid program's provision of health insurance for elders, the disabled, and poor families. From fiscal year 1987 to fiscal year 1990, Medicaid costs have gone from $1.4 billion to $2.1 billion, about 16 percent of the total state budget, and they are still projected to grow.[17]

Payments for recipients of Aid to Families with Dependent Children represent over $550 million of the state budget. Other entitlement programs include emergency

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[16] From fiscal year 1990 "Cherry Sheet" totals, Massachusetts Department of Revenue.

[17] See Memorandum on "The Budget Situation" from Senator Patricia McGovern to Members of the Massachusetts Senate (November 17, 1989).

assistance, Supplemental Security Income (SSI), general relief, and services for the homeless.

The state cannot easily cut entitlement programs to balance the state's budget, since any reduction in these programs hurts those most in need of government support. The state can only reduce its liability for entitlement programs by restricting service eligibility and changing the nature of the entitlement. The recent debate on restricting undocumented immigrants from receiving public benefits is an example of such an approach.

C. DEBT SERVICE, PENSIONS, MBTA CONTRACT ASSISTANCE

The state's non-discretionary expenses also include general obligation bond payments, pension obligations, and MBTA financing -- costs to the state also labeled "budget busters" by Senator McGovern. In fiscal year 1990, general obligation bonds payments are expected to be $718 million, while pension payments are scheduled to be $646 million.[18] Together these represent 11 percent of the budget, and they are still growing.

The state's legal obligations to the MBTA are also growing. In the period from fiscal year 1987 to fiscal year 1990, MBTA payments went from $219.3 million to $395.4 million.[19]

School Building Assistance payments and lease payments represent smaller additional portions of the state's contractual obligations. School Building Assistance Payments for fiscal year 1990 totaled $128 million and are accounted for in the budget of the Department of Education. Lease payments totalling approximately $50 million are

[18] See "Official Statement, The Commonwealth of Massachusetts," pp. 47 and 53.

[19] See Memorandum on "The Budget Situation" from Senator Patricia McGovern.

funded within the agency operations accounts.[20]

D. AGENCY OPERATIONS

The agency operations portion of the state budget pays for the salaries of most state employees and for the "non-entitlement" programs supported by the state. These account for less than one-third of the total state budget, and are often considered the one "discretionary" portion.

Although this section of the budget is considered "discretionary," it includes funding for essential governmental services such as the functions of the Department of Revenue, public health programs, corrections, or other services that are far from "discretionary." In the five year period from fiscal year 1984 through fiscal year 1989, agency operations actually shrunk as a percentage of the total budget, from 34.7 percent to 32.5 percent.[21]

For the state to close the gap between revenues and expenditures with cuts in state expenditures, the cuts would come out of the so-called "discretionary" third of the budget, and not from either local aid or the non-discretionary accounts. With only half of the fiscal year remaining, implementing cuts from the "discretionary" third of the budget would require a 30 percent cut in these accounts. Cuts at this level would decimate governmental operations and services.

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[20] See "Official Statement, The Commonwealth of Massachusetts," p. 49.

[21] See "Official Statement, The Commonwealth of Massachusetts," p. 26.

SECTION FOUR: CONCLUSIONS
Resolving the Crisis

Massachusetts is not alone in its financial hardship. Many other states, including New York, Connecticut and New Jersey, have experienced significant downturns in revenues. Massachusetts is alone, however, in its failure to respond to the fiscal crisis. Other states have answered declining revenues with major revenue enforcement efforts or with tax increases.

There have been calls for balancing the state's budget through cuts alone. The news media repeatedly publish stories indicating a government bloated with waste and extraneous employees. To date, however, none of the proposals for spending cuts would be sufficient to make up the state's budget deficit. It is clear from the nature of the fiscal crisis that reducing expenditures sufficiently to close the gap between revenues and expenditures would destroy even the most essential functions of the government of Massachusetts.

Unlike many other states, Massachusetts cannot rely on greater revenue collection measures to make up for revenue shortfalls, because effective revenue enforcement measures are already in place. Since 1983, the Massachusetts Department of Revenue has been aggressive and successful in collecting a high percentage of delinquent taxes. In fiscal year 1989 alone, enforcement collections for the Department totalled an unprecedented $526 million -- a $162 million increase over the prior year's record.[22] Because of the effective enforcement measures already in place, additional enforcement will not be able to close the gap if revenues continue to decline.

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[22] Figures from the Massachusetts Department of Revenue, November 29, 1989.

The state is also having difficulties in addressing the fiscal crisis with tax increases. Massachusetts has not been able to raise new taxes, partly because of a major public crisis of confidence. Citizens of Massachusetts have the right of referendum and the right to free petition, creating a sentiment among political leadership that new taxes will be met with immediate repeal.

Several circumstances coincided to create the public reaction to the state's fiscal crisis. The rise of anti-tax and anti-government factions has promoted this climate of distrust. The slowdown in the state's economy followed the Governor's failed presidential bid, and its attendant focus on the "Massachusetts miracle." The Governor claimed credit for the strength of the Massachusetts economy during the campaign, and there was a tendency to hold him responsible when the economy turned. He became a scapegoat for problems which were largely unforeseeable.

There are two criticisms of the Administration that do seem justified. First of all, given the uncertainty created by federal tax law changes and changes in the national economy, revenue projections should have been more conservative. This is especially true given the impact of over-prediction on the state budget. Second, the Governor should have acted more quickly to make necessary cuts when revenue projections indicated that there would be revenue shortfalls.

Any solution to the state's fiscal crisis must do more than plug one-year's gap between revenues and expenditures. Even with a solution to this year's fiscal crisis, unless the state reins in its non-discretionary expenditures, or if revenues decline much further, the state is likely to experience another shortfall in fiscal year 1991. If the political leadership of the state do not take decisive action, the fiscal crisis could become a yearly event.

The Legislature and the Governor are responsible for making the fundamental decisions about the role of government for the people of the Commonwealth. If the choice is to dramatically reduce the size and role of government, this is not a decision that can be implemented overnight. In any case, the state will continue to have the need of additional revenues during a time of transition.

The state's fiscal crisis can be seen as an opportunity for the Legislature and the Administration of the Commonwealth of Massachusetts. It is an opportunity for political leadership to take seriously its responsibility to define the shape and role of government for the foreseeable future.